

CHAPTER 1

ELIGIBILITY FOR SBA GUARANTY LOAN PROGRAMS

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The purpose of the SBA's lending program is to help small businesses obtain credit, where financing is not otherwise available on reasonable terms. Most SBA loans are long-term in nature, since longer maturities are generally less available in the private sector.

It is not SBA's intent to finance those businesses which cannot meet prudent lending criteria involving management, owner capitalization and repayment ability. It is not the aim of the program to guaranty loans to businesses which might be identified as high risk, unbankable, or without a reasonable assurance of repayment ability.

Most businesses are eligible for SBA loans. Eligibility of a particular case is determined by several factors:

- Credit Elsewhere
- Utilization of Personal Resources
- Type of Business
- Size of Business
- Secretary of State On-Line Searches
- Purpose of Loan
- Special Circumstances
 - Eligible Passive Company (EPC)
 - Franchises
 - Recreational Facilities and Clubs
 - Change of Ownership
 - Farms and Agricultural Businesses
 - Fishing Vessels
 - Medical Facilities
 - Businesses Located in a Foreign Country or Owned by Aliens
 - Litigation
 - Bankruptcy
 - Probation or Parole
 - Student/Government Loans
- Piggyback Financing

The rest of this chapter focuses on each of these factors.

CREDIT ELSEWHERE

As an Agency of the Federal Government that relies upon federal taxpayer dollars to support its lending programs, the SBA cannot provide financial assistance to small businesses that have the ability to reasonably obtain the financing without federal assistance.

Therefore SBA has a "credit elsewhere test" to which all business loan applicants are subject. The regulatory requirements of this "test" are detailed in §120.101.

- a. The Credit Elsewhere "Test": Credit Elsewhere is an eligibility factor that must be determined prior to assessing the credit factors of a loan request. The purpose of Credit Elsewhere is to determine if the applicant concern along with its affiliates and principals has the ability to obtain some or all of the requested loan funds from alternative sources without causing undue hardship to the applicant, its affiliate(s), or principal(s). These alternative sources include:

- The lending institution;
- The internal resources of the applicant concern;
- The external resources of the applicant concern; and
- The personal resources of the applicant concern.

If the financial assistance applied for is otherwise available on reasonable terms from any of these sources, the application must be denied.

- b. The Lending Institution as an Alternative Source: Lending institutions are a source of credit for small businesses. If a lending institution will provide the credit to the small business applicant, on reasonable terms, without SBA support, the requested financing is not eligible for SBA consideration. As part of the Credit Elsewhere Test, every lender who applies to SBA for a guaranty of a loan they propose to make to a small business must signify that they could not make the proposed loan without SBA support. Lenders have to substantiate their compliance with the credit elsewhere rules.
- c. Lender Substantiation of Compliance with Credit Elsewhere Rules: 504 third-party lenders and 7(a) lenders must explain to SBA the factors that prevent the financing from being accomplished without SBA support. The CDC or 7(a) lender must retain the explanation in the applicant's file. The CDC may use this information to satisfy the requirements of Exhibit #19 of the Application for 504 Loan (SBA Form 1244), Part A, when it applies for a 504 loan. Microloan intermediaries (microlenders) must have a letter of decline from an institutional lender such as a bank for loans of \$15,000 or more in the applicant's file. Substantiation is not required for microloans of less than \$15,000.

- d. What Factors Are Acceptable as Substantiation? Acceptable factors are those that demonstrate an identifiable weakness in the credit or exceed policy limits of the lender. These factors include, among others:
- (1) The business needs a longer maturity than the lender's policy permits (for example, the business needs a loan that is not on a demand basis);
 - (2) The requested loan exceeds either the lender's legal limit or policy limit regarding the amount that it can loan to one customer;
 - (3) The lender's liquidity depends upon selling the guaranteed portion of the loan on the secondary market;
 - (4) The collateral does not meet the lender's policy requirements because of its uniqueness or low value;
 - (5) The lender's policy normally does not allow loans to new ventures or businesses in the applicant's industry; and/or
 - (6) Any other factors relating to the credit that, in the lender's opinion, cannot be overcome except for the guaranty.
- e. What Factors Are Not Acceptable Substantiation? Any factors related solely to a lender's choice to obtain a guaranty without any identifiable weakness in the credit or, failure of the credit to meet the lender's established policies or regulatory restrictions are unacceptable. Typical examples of when SBA's guaranty is sought for unacceptable reasons:
- (1) Substantiate Community Reinvestment Act (CRA) compliance;
 - (2) Improve the lender's collateral lien position;
 - (3) Refinance debt already on reasonable terms;
 - (4) Comply with the requirement for small business lending companies (SBLCs) that SBA guarantee all loans.
- f. What is the Certification Process under Credit Elsewhere? For 7(a) loans, the lender must certify that credit is not otherwise available by signing the Lender Official block on the appropriate application form. The lender's certification is:

"I approve this application to SBA subject to the terms and conditions outlined above. Without the participation of SBA to the extent applied for, we would not be willing to make this loan, and in our opinion the financial assistance applied for is not otherwise available on reasonable terms. I certify that none of the Lender's employees, officers, directors or substantial stockholders (more than 10 percent) have a financial interest in the applicant."

A certification requirement or procedure does not exist for microlenders.

For 504 loans, the third-party lender must send a written explanation to the CDC stating the reasons it will not finance the project without SBA support. The CDC must also write an explanation stating why the financing is not otherwise available.

- g. Must Consideration of Prevailing Rates and Terms Be Documented? No, except as noted above for microlenders, the SBA assumes the lender has considered the prevailing rates and terms in its market. Just because the lender knows what may be available on an isolated basis does not require a referral of credit to another lender.
- h. The Importance of Providing Credit on Reasonable Terms: All debt guaranteed by SBA is on reasonable terms when made. Lenders certify this when they request SBA to guaranty the loan they propose to make to their applicant. SBA does not refinance debt that is already on reasonable terms. Therefore, it is important to understand how SBA determines if a debt's terms and conditions are reasonable or why they are no longer reasonable in order to confirm that the lender's certification was correct and to know whether one of the refinancing eligibility factors has been satisfied.
- i. Guidelines to Determine if Credit Terms are Reasonable: Generally, structuring debt in accordance with the need being financed and within the repayment ability of the borrower is reasonable and prudent financial management. We do not encourage small businesses to finance fixed asset purchases with demand notes or revolving lines of credit. We also find that loans have unreasonable credit terms if they require a debt service burden that is in excess of debt service ability.

Another reason existing terms can be deemed unreasonable is when they do not allow the applicant concern the ability to accumulate equity in the assets being financed for a prolonged period of time (such as a 10-year interest only debt due in full at maturity) or when the loan is clearly for the benefit of an individual (such as a seller take-back note amortized over 35 years).

- j. How is the Availability of Credit on Reasonable Terms Determined? When evaluating whether loans available from non-Federal sources are on reasonable terms, consider if the loan amounts, interest rates, maturities, payment schedules, and loan conditions from these sources can be reasonably accommodated from the cash flow of the small business. Although a small business may be able to obtain a loan from a non-Federal source, the terms or conditions may not meet its needs, and therefore be classified as unreasonable. If the business is unable to get financial assistance from non-Federal sources on terms and conditions that meets its business needs, SBA has determined that the desired credit is deemed to be not available on reasonable terms.
- k. Is Credit Card Debt Considered Reasonable? Only if the credit needed by the small business is short term in nature might credit card debt be on reasonable terms, depending on the rate of interest and other terms of the credit card debt.
- l. Are Balloon Notes Considered Reasonable? No. Many businesses find the stability provided by fully amortized long-term debt preferable to shorter maturities with a long amortization (balloon notes), even though interest rates may be lower on the latter. The following are concerns about balloon notes:

- Condition and willingness of the lender to refinance;
- Interest rate changes;
- Prevalent market conditions in the future; and
- Renewal fees.

Small businesses need to be able to match the maturity of the loan to the expected economic life of the assets being financed. Notes with balloons frequently hinder small businesses from planning effectively.

- m. Are Demand Notes Considered Reasonable? No. Demand notes put a business in a position where its debt financing is uncertain and is at the discretion of the lender. If the note is called, which may occur for any reason, the business may not be able to obtain other financing. This unduly jeopardizes the continued existence of the business.
- n. Are Interest Only Notes Considered Reasonable? Maybe. The determination has to be made on a case-by-case basis.

Intermediate and long-term debt that requires only interest payments until the debt matures is not reasonable. Such a structure may be used for seller take-back financing of a business but the purchaser could just as easily be paying rent. The unreasonableness here is that such a loan does not allow the business to accumulate any equity in the assets being acquired rather than the inability of the borrower to be able to repay the loan.

Lines of Credit that accept either interest only or principal and interest payments until a stated maturity or demand is made may be considered reasonable if the borrower properly maintains their line.

Seasonal lines that require interest only payments for a specified period and then principal and interest for the reciprocal period are generally reasonable.

- o. Internal Resources as an Alternative Source: SBA requires that borrowed funds be unobtainable through the disposal, at a fair price, of assets owned by the applicant business, that are not needed by the business to conduct its operation or not reasonably necessary for healthy growth.

In addition to considering the internal resources of the applicant concern as a source of credit at the time of application, the internal resources of the applicant concern after disbursement have to be considered a potential source.

Consider an existing printing company with three printing presses that desires to replace its oldest press. Proceeds can be authorized to acquire and install the new press as well as to remove the old press. If the applicant no longer needs the old press, it can be sold. Under such circumstances the proceeds from the sale are to be applied against the loan's outstanding balance.

- p. External Resources as an Alternative Source: SBA also requires that the borrowed funds must be unobtainable through the disposal, at a fair price, of assets owned by any of an applicant's affiliates, that are not needed by the affiliate for its operation or that are not reasonably necessary for the affiliate's healthy growth.
- q. Personal Resources as an Alternative Source: Reference the pages following this section which pertain to "Utilization of Personal Resources".

For additional examples and questions/answers pertaining to Credit Elsewhere, please reference SOP 50-10(4), Pages 11 through 14-2.

Exercise: Take a few minutes to answer whether credit is available for the borrowers in the problems presented below. Answers are provided in Appendix 1-A.

1. The borrower is a corporation that needs to borrow \$75,000 to purchase a new model of equipment that costs \$85,000. The business is trading in an old model to use for the down payment. The bank's policy manual states that equipment may be financed up to 60 months at 50% loan to value. This would limit the loan amount to \$42,500 by commercial standards. Would this circumstance allow SBA financing?
2. The business principal owns a personal residence free and clear. The principal could obtain financing for the equipment (referenced in problem 1 above) using a 1st mortgage and a personal note through the lender's mortgage department, based upon regular mortgage standards. Is the credit now available elsewhere?
3. A business corporation owns its own building with no debt. The lender is willing to provide the equipment financing with a 1st mortgage on the building without an SBA guaranty, but the business owner wishes to use equipment only and utilize the SBA guaranty. Is this an example of credit available elsewhere?
4. A business applies for a loan and its lender is unable to offer the long term financing needed by the business to service the debt without an SBA guaranty, according to the lender's policies. However, borrower provides a copy of written commitment information that another competitor institution has already approved the loan under the same terms and conditions offered by this lender, and without an SBA guarantee. The lender submits the SBA loan application because its own internal policies would not allow the credit on the requested terms and conditions without an SBA guaranty. Has the lender met the credit unavailable elsewhere test given the evidence that another lender approved the same terms without an SBA guaranty?

UTILIZATION OF PERSONAL RESOURCES

As part of its credit elsewhere test, SBA regulations require the personal assets of all owners of 20% or more of the applicant firm (or operating company) be reviewed and subject to injection in lieu of loan proceeds. This regulation is commonly known as the “utilization of personal resources test” a/k/a “UPR”. The regulatory requirements of this "test" are detailed in §120.102.

- a. What is the Purpose of the Personal Resources Rule? Utilization of personal resources is a matter of eligibility for both the 7(a) and 504 programs and is required by authorizing legislation. The purpose is to restrict the use of Government-backed funding, when that funding, or a portion of it, is available from the personal resources of those individuals who stand to benefit most from the funding.

An applicant for a business loan must show that the desired funds are not available from the personal resources of any owner of 20 percent or more of the equity of the applicant. SBA will require the use of personal resources from any such owner as an injection to reduce the SBA funded portion of the total financing package (i.e., any SBA loans and any other financing, including loans from any other source) when that owner's liquid assets exceed the amounts specified in paragraphs (a)(1)-(3) of this section. When the total financing package:

- (1) Is \$250,000 or less, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of two times the total financing package or \$100,000, whichever is greater;
- (2) Is between \$250,001 and \$500,000, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of one and one-half times the total financing package or \$500,000, whichever is greater;
- (3) Exceeds \$500,000, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of one times the total financing package or \$750,000, whichever is greater;

- b. To Whom Does the Personal Resources Rule Apply? The Rule applies to each person who is at least a 20 percent owner as a matter of eligibility. The rule also applies to each person who owns less than 20 percent when that person is married to another owner and/or has dependent children whom are owners when the combined ownership of the spouses and/or dependent children is 20 percent or more. The utilization of personal resources rule does not apply to the business resources of an associate or affiliated business.

- c. Are Personal Resources of Spouses Included? The SBA's lending programs qualify as "Special-Purpose Credit Programs" under the Federal Reserve's Regulation B relating to the Equal Credit Opportunity Act (ECOA). This regulation stipulates that information pertaining to the applicant's marital status, sources of personal income, alimony, child support, and spouse's financial resources can be obtained and considered in determining program eligibility. Therefore, the lender has the right to obtain the signature of an applicant's spouse (whether an owner of the business or not) or other person on an

application or credit instrument relating to a special-purpose program if it is required by Federal or State law.

Credit instruments as used here refer to mortgages, personal guarantees (limited to the person's interest in the collateral), or similar documents.

Unless there is some legal impediment to access the personal resources of the spouse such as those held by an independent trustee of an irrevocable trust, the applicant is presumed to have access to the personal resources of his/her spouse and minor children. As a matter of policy, the personal resources of close relatives (excluding spouse and dependent children), including children above the age of majority, living in the household are not considered to be available to the applicant for injection into the business.

As a credit matter, SBA cannot require the injection of the spouse's personal resources, but can determine that the applicant is ineligible because of access to personal resources. The SBA can require injection of the available personal resources of the individual's minor children.

c. What are the Requirements of the Utilization of Personal Resources Rule?

Requirements of the rule are:

- (1) Only individuals (not businesses) who own 20 percent or more of the small business concern (SBC) or the eligible passive company (EPC) are subject to this rule. Officers, directors, and key management owning less than 20 percent of the SBC or EPC who may otherwise be considered a principal or associate will not be subject to this rule.
- (2) The exemption thresholds are based on the total financing package, not just the loan that SBA guarantees.
- (3) Only liquid assets are subject to the rule.
- (4) There are no additional exemptions. This means there are no exemptions for education, retirement funds not subject to withdrawal restrictions or other penalties, medical reserve fund, business contingency, or any other type of exemption that originates from a personal desire.
- (5) Spouses (and any dependent children) with a combined ownership interest of 20 percent or more in the applicant (or EPC) will be subject to the rule.

Once it is determined that an individual owner is subject to the utilization of personal resources rule, their percentage of ownership has no effect on the amount of their required injection. If a 20 percent owner has personal liquid assets of \$1,000,000 and the 80 percent owner has personal liquid assets of \$200,000, SBA will not give consideration to allowing the 20 percent owner to be anything but fully subject to the utilization rules. The owners must resolve among themselves any issues of fairness arising because of different ownership percentages.

The exemption is determined as of the date of application. You must carefully consider whether the requested loan amount is appropriate for the business. This will lessen the possibility that an applicant could inflate its loan request to increase its exemption and later request a decrease in the loan.

- e. How is the Amount of the Personal Exemption Determined? Lenders and CDCs use the following procedures to make a written determination that they must keep in the file, available for SBA's review:
 - (1) Determine the overall dollar value of the allowable exemption on the basis of the "total financing package", using the definition of total financing package found in subparagraph "g" in this section;
 - (2) Carefully review the personal financial statements required from the owners of 20 percent or more of the equity of the business (including the resources of spouse and dependent children [immediate family unit]);
 - (3) Determine the value of the liquid assets subject to the rule for each individual; and
 - (4) Subtract the exemption from the liquid assets of each individual (including their immediate family unit), subject to the rule.
- f. What are the Requirements Imposed on the Excess Liquid Assets? The amount by which the value of the liquid assets exceeds the value of the allowable exemption must be injected into the business, reducing the amount of the SBA loan requested.
- g. What is Included in the "Total Financing Package"?
 - (1) Financing Package for 7(a) loans: The total financing package includes the SBA loan, together with any other loans, equity injection, or business funds used or arranged for at the same general time for the same project/need/goal as the SBA loan. This includes the total non-SBA financing in a 7(a) piggyback arrangement.
 - (2) Financing Package for 504 loans: The total financing package includes all elements of financing for the project (the permanent third party senior loan, the 504 debenture, and the applicant injection/contribution) and any other loans or injection made at the same time as the 504 loan, such as for working capital to accomplish the project/need/goal.
- h. Which Assets Are Not Considered "Liquid Assets"? "Liquid assets" do not include: Closely held non-marketable stocks; individual retirement accounts (IRAs), 401K, Keogh, or other established retirement accounts subject to withdrawal restrictions or penalties; and other similar assets. All other liquid assets are subject to the rule, including savings accounts, CDs, stocks, bonds, or other similar assets. Equity in real estate holdings and other fixed assets are not to be considered liquid assets. You should consider carefully the transfer of assets or other actions of the applicant to avoid compliance with the intent of this provision. At a minimum, liquid assets transferred by applicants within 6 months of application for SBA assistance will not be exempt.

- i. Is the Cash Surrender Values of Life Insurance Included? For purposes of the personal resources “test”, the cash surrender value of life (CSV) of life insurance is a liquid asset unless the policy has been assigned as part of the requested financing or assigned to an existing loan. Under such circumstances, an individual’s total personal liquid asset (including CSV) can be reduced by the lesser of the cash surrender value pledged to secure a debt or the amount of the debt. If CSVs were not considered liquid assets, an applicant might be able to circumvent the personal resource requirement by using liquid assets to purchase a life insurance policy with this feature.
- j. Is there an Additional Exemption for Pledged Liquid Assets? For purposes of the personal resources “test”, the liquid assets that serve as security on other debt (obtained more than 6 months prior to the date of application) may be exempted from the calculation of total available personal liquid assets. However, the dollar value of the liquid assets that can be exempted can be no greater than the lesser of the amount of the debt or the amount of the face value of the liquid assets securing the debt.
- k. Can the Borrower Pledge Liquid Assets Rather Than Inject Liquid Assets? Liquid assets required to be injected into the business under the utilization of personal resources cannot be pledged as an alternative to injection.
- l. Do Personal Resource Limits Affect Capitalization Requirements? The personal resource limits do not restrict the Agency’s ability to require additional capitalization beyond that required by the personal resources policy if additional capitalization is necessary to make a loan creditworthy. Availability of personal resources must be considered when evaluating any change to the original loan amount.
- m. How does SBA view the practice of a person reducing their ownership interests to avoid being subject to SBA’s personal resources, character, and/or personal guaranty requirements?

Per 13 CFR 120.10(3), the time during which an associate relationship exists commences 6 months before the date SBA receives an application for business loan assistance. The definition of associate includes all individuals who own 20 percent or more of the applicant concern. These individuals are subject to: the utilization of personal resources rule, character evaluation via the SBA Form 912 process, and the requirement to personally guarantee the debt.

Under the regulation, if an individual who owns 20 percent or more of the applicant firm changes their ownership percentage to less than 20 percent within 6 months of applying for SBA business loan assistance, that individual is still subject to the requirements for personal resource utilization, good character, and personal guarantee execution.

The only exception to the 6-month associate rule would be when owners of 20 percent or more of the applicant concern (individual and/or entity) completely divests their interest. Complete divestiture is not only divestiture of all ownership interest but total removal from

the applicant concern (and any associated EPC) in any capacity, including being an employee (paid or unpaid).

Since credit elsewhere and character are factors of eligibility and eligibility is determined at the time an application is received, the individual or entity must be completely divested prior to application submission in order to not be subject to the utilization of personal resources rule and good character verification (including review of the Statement of Personal History, SBA Form 912).

Since personal guarantees are factors of collateral, SBA will permit a loan to be authorized without requiring an individual or affiliate who would otherwise be required to guarantee, to be omitted from having to guarantee, if, and only if, they are completely divested prior to initial disbursement.

Appendix 1-B includes an Excel spreadsheet, "Calculation of Excess Personal Resources" that you may find helpful when determining borrower eligibility.

Exercise: Take a few minutes to answer questions related to personal resources in the situations described below. Answers are provided in Appendix 1-A.

AAA Heating, Inc. wants to restructure their finances, buy new equipment and construct a new building. The business has been very successful through the years. Three individuals own the capital stock of the corporation, each owning 1/3 interests. The company will need financing of \$1,500,000 from your institution and \$500,000 from a first mortgage lender.

Refinancing of Current 1 st Mtg.	\$500,000
Construction of new building	\$1,225,000
Inventory Purchase	\$100,000
Storage racks for new building	\$75,000
New Vehicles	\$100,000

The applicant has secured a first mortgage commitment of \$500,000 at much more favorable rates than you can offer.

Stockholder #1 is Robert Price. Mr. Price is 74 years old and is also the president of the corporation. He started the business some 23 years ago, after a long career with another heating company. He is married to Mary. Mr. Price has in his own name Certificates of Deposit that are worth \$750,000 and savings accounts of \$225,000. He also has an irrevocable trust that was taken out several years ago for the benefit of one of his children who, because of medical reasons, is not self supporting. This trust is worth \$1.5 million. Mary Price has \$750,000 in Certificates of Deposit and savings of \$80,000.

Mr. & Mrs. Price's son David, stockholder # 2, also owns 1/3 of the Applicant Company. David is 45 years old and is married to Jane. They have two children, David II, (age 15) and Henry, age 22. David has a total of \$19,000 in liquid assets in his name. Jane has cash of \$55,000, CDs totaling \$200,000, marketable securities worth \$750,000 and owns a summerhouse at the beach worth \$150,000. Their son David has accumulated considerable liquid assets for his young age,

having \$375,000 in cash, \$800,000 in CDs and \$1,500,000 in marketable securities. Henry hasn't done as well as David, having a degree in political science and large college debts but no liquid assets.

Stockholder #3 is George Benderson. Mr. Benderson has been with the company for about 10 years and owns the remaining third of the business. Mr. Benderson is single and has no dependents. Mr. Benderson has \$90,000 in CDs, \$200,000 in CSV life insurance, \$15,000 in savings, a home, which is free and clear worth \$200,000 and \$350,000 in marketable securities.

1. What is the total Financing package?
2. What individuals come under the liquid personal resource provisions of the SOP?
3. What assets of the individuals must be considered liquid and available under the provision, and how much will they be mandated to contribute?
4. What will be the amount of the SBA loan request?

TYPE OF BUSINESS

An eligible business must be organized for profit and must be engaged in or propose to do business, in the United States or its possessions.

The great majority of the types of businesses that exist **are eligible** for financial assistance from the Small Business Administration.

THE FOLLOWING TYPES OF BUSINESSES ARE INELIGIBLE:

- Non-profit businesses (for-profit subsidiaries are eligible)
- Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances)
- Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies discussed in SPECIAL CIRCUMSTANCES later in this Chapter.
- Life insurance companies (however, an independent insurance agent that meets the qualifications as an independent contractor, regardless of whether the agent sells for one company or several companies, is eligible for financial assistance)
- Businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify)
- Pyramid sale distribution plans
- Businesses deriving more than one-third of gross annual revenue from legal gambling activities
- Businesses engaged in any illegal activity
- Private clubs and businesses which limit the number of memberships for reasons other than capacity
- Government-owned entities (except for businesses owned or controlled by a Native American tribe)
- Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting
- Consumer and marketing cooperatives (producer cooperatives are eligible)

- Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans
- Businesses with an Associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude
- Businesses in which the Lender or CDC, or any of its Associates owns an equity interest
- Businesses which present live performances of a prurient sexual nature; or derive directly or indirectly more than *de minimis* gross revenue through the sale of products or services, or the presentation of any depictions or displays, or a prurient sexual nature
- Businesses that have previously defaulted on a Federal loan or Federally assisted financing, resulting in the Federal government or any of its agencies or Departments sustaining a loss in any of its programs, and businesses owned or controlled by an applicant or any of its Associates which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the Federal government or any of its agencies or Departments to sustain a loss in any of its programs (for purposes of this section, a compromise agreement shall also be considered a loss)
- Businesses primarily engaged in political or lobbying activities
- Speculative businesses (such as oil wildcatting and dealers of rare coins and stamps)

SIZE

Since the Small Business Administration can only lend to **small business**, it has defined "small", establishing standards by type of industry. Individual *types* of businesses within these broad industry categories **may** have different standards. Most businesses are considered small by SBA's size standards.

The standard for an industry is based on **either number of employees** (calculated by averaging the total number of employees for each pay period during the most recently completed 12 calendar months) **or** average **annual receipts** for the most recently completed 3 fiscal years.

Industry

Retail and Service
Construction
Agriculture
Wholesale
Manufacture

Size Range

\$1.5 to \$24.0 million
\$12.0 to \$28.5 million
\$0.75 to \$10.5 million
No more than 100 employees
500 to 1,500 employees

If a potential borrower is **close** to these standards, discuss the size eligibility issue with the local SBA office. The specific standard for a particular business may change from time to time and some exceptions may apply.

SBA adopted a new industrial classification system that more accurately reflects the composition of today's small business sector. It will serve as the basis for the agency's widely used small business size standards. The new system, known as the North American Industry Classification System (NAICS – pronounced "nakes"), replaced the Standard Industrial Classification (SIC) system. SBA has posted the Table of Small Business Size Standards matched to North American Industry Classification (NAICS) on its website at www.sba.gov/size. To order the 1250-page manual in print or CD-ROM, call NTIS at 800/553-6847 or 703/605-6000 or visit the NTIS website at www.ntis.gov.

A business that meets SBA's size standards at the time of application is considered eligible even though the loan proceeds will result in an increase beyond those standards.

When affiliations exist with other companies (for example, through common ownership, directorships or by contractual arrangements), the **primary business activity** must be determined **both** for the applicant business as well as for the entire affiliated group. In order to be eligible for financial consideration, the applicant must meet the size standard for **its** primary business activity and the affiliated group must meet the standard for **its** primary business activity.

EXAMPLE - SIZE DETERMINATION
(Applicant & Its Affiliated Companies)

	Applicant	Affiliate 1	Affiliate 2	
	Johnson	Beta	Southside	
	<u>Concrete</u>	<u>Construction</u>	<u>Builders</u>	<u>Total</u>
Sales:	\$1,500,000	\$2,500,000	\$1,700,000	5,700,000
Employees:	35	100	25	160
NAICS Code:	327320	233210	421310	

Size standards show the following:

Manufacturing Ready-mix Concrete (327320)	500 employees
Single Family Housing Construction (233210)	\$27.5 million in sales
Wholesale lumber, plywood, millwork and wood panel (421310)	100 employees

Where the affiliates are engaged in several industries, the size standard is that of the primary industry of all the related concerns taken as a whole. The annual sales receipts (or number of employees, as appropriate) must be totaled and applied against the standard of the primary industry. The primary industry in this case is NAICS Code 233210, Single Family Housing Construction, having \$27.5 million as the size standard. With only \$5.7 million in average sales for the last 3 fiscal years, the applicant and its affiliates are well within the size standard.

Note: If a business which has affiliates exceeds the size standard(s), you should review intercompany sales/employees and remove all intercompany transactions prior to averaging to determine size.

Note: The regulatory language regarding affiliation is included as Appendix 1-C.

Exercise: Take a few minutes to determine if a small business is eligible based on the following scenarios. Answers are provided in Appendix 1-A.

1. Applicant is a housecleaning service with \$3.2MM annual sales and 45 employees. Is it small?
2. Business is a manufacturer of soaps with \$25.0MM annual sales and 725 employees. Is it small?
3. What happens if the housecleaning service is a wholly-owned subsidiary of the manufacturer of soaps; say as a side business to test out new products?
4. Can we do anything to make this situation eligible?

SECRETARY OF STATE ON-LINE SEARCHES

On-line searches of the Secretary of State records are needed for several reasons:

- (1) To assure the business is properly registered to do business in the State of Florida
- (2) To verify whether any affiliate(s) exist(s)
- (3) To verify ownership, officers and directors

For the State of Florida, you may access the Secretary of State records on-line at www.sunbiz.org. You should check the borrower entity (either corporation, partnership or fictitious name). You should also check under the names of all principals and their spouses (since a business owned by a spouse is considered an affiliate for size standard purposes). Check for their names as officer/director of corporations, a partner in partnerships or as a sole proprietor under fictitious name filings.

- ☼ Search by corporation name
 - corporate information & status
 - corporate officers & directors
- ☼ Search by partnership name
 - partnership information & status
 - general partner
- ☼ Search by fictitious name
 - “d/b/a” information & status
 - owner name
- ☼ Other searches
 - Federal employer identification number
 - Owner/officer/director/partner name

PURPOSE

A small business must use an SBA business loan for sound business purposes. The uses of proceeds are prescribed in each loan's Authorization. A Borrower may use loan proceeds from any SBA loan to:

- Acquire land (by purchase or lease)
- Improve a site (e.g., grading, streets, parking lots, landscaping), including up to 5 percent for community improvements such as curbs and sidewalks
- Purchase one or more existing buildings
- Convert, expand or renovate one or more existing buildings
- Acquire (by purchase or lease) and install fixed assets
- Inventory, supplies, raw materials and working capital

Proceeds of an SBA loan **cannot** be used to:

- Finance floorplan needs
- Purchase real estate where the participant has issued a forward commitment to the builder/developer
- Where the real estate will be held primarily for investment purposes, except as follows:

If the loan proceeds involves the acquisition, renovation, or reconstruction of any **existing** building, the Borrower (or Operating Company, if the Borrower is an Eligible Passive Company) must occupy at least 51% of the property. The balance of the property may be leased to any third party, as long as the loan proceeds are not used to remodel or convert the leased space.

If the loan proceeds involve the construction of a **new** building:

For non-EPC Loans, Borrower must:

1. immediately occupy at least 60% of the rentable property,
2. continue to occupy at least 60% of the rentable property for the term of the loan,
3. lease long-term no more than 20% of the rentable property to one or more tenants,
4. plan to occupy within 3 years some of the remaining rentable property not immediately occupied or leased long-term, and
5. plan to occupy within 10 years all of the rentable property not leased long term.

For EPC loans:

1. Borrower must lease 100% of the rentable property to the Operating Company,
2. Operating Company must immediately occupy at least 60% of the rentable property,
3. Operating Company will lease long-term no more than 20% of the rentable property to one or more occupants,
4. Operating Company must plan to occupy within 3 years some of the remaining rentable property not immediately occupied or leased long term, and
5. Operating Company must plan to occupy within 10 years all of the rentable property not leased long term.

The rule does not allow construction of new facilities just to give a Borrower permanent rentable space (beyond the allowable 20%). It provides for construction of facilities which exceed the present need only when it can be reasonably forecast that the business will need some additional space within 3 years and all of the extra space in 10 years. This flexibility is provided in order for the company to benefit from the reduced costs of construction when compared to the like costs of additions and renovations in future years.

Rentable property is the total square footage of all buildings or facilities used for business operations. This policy refers to interior space only.

- Make payments to owners or pay delinquent withholding taxes, sales tax or similar funds.
- Purchase a portion of a business or a portion of another owner's interest. One or more current owners may use loan proceeds to purchase the entire interest of another current owner, or a Borrower can purchase ownership of an entire business.

SEE FURTHER DISCUSSION OF PURPOSE/USE OF FUNDS AND DEBT REFINANCING UNDER **CHAPTER 2, LOAN PROCESSING.**

SPECIAL CIRCUMSTANCES

Other special circumstances, such as those described below, may have an impact on eligibility.

ELIGIBLE PASSIVE COMPANY (EPC, formerly ALTER EGO)

While investment in real estate occupied by anyone other than the small business concern is **not eligible**, an Eligible Passive Company **may be eligible** if the conditions listed below are met. Under EPC, the entity that receives SBA financial assistance is not the operating small business, although the Operating Company is the ultimate beneficiary. Under the EPC rule, commonality of ownership is no longer required. Any ownership structure or legal form may qualify as an Eligible Passive Company, including a **revocable** or irrevocable trust, individuals owning the real estate as tenants in common or limited liability companies. **There may be multiple operating companies but only one EPC.**

An Eligible Passive Company must use loan proceeds to acquire or lease, and/or improve or renovate real or personal property (including eligible refinancing) that it leases to an Operating Company for the conduct of the Operating Company's business. **Part of business loan proceeds may be used for the working capital of the Operating Company or for purchasing machinery and equipment that will be reflected on the Operating Company's balance sheet.**

Conditions that apply to all legal forms:

- The Operating Company must be an eligible small business, and the proposed use of the proceeds must be an eligible use if the Operating Company were obtaining the financing directly.
- The Eligible Passive Company (with the exception of a trust) and the Operating Company each must be small under the appropriate size standards included in this manual. When determining size, the EPC is not combined with the Operating Company unless an affiliation exists. The fact that the EPC is leasing the project property to the Operating Company does not in and of itself create an affiliation.
- The lease between the Eligible Passive Company and the Operating Company must be in writing and must be subordinated to SBA's mortgage, trust deed lien, or security interest on the property. Also, the Eligible Passive Company (as landlord) must furnish as collateral for the loan an assignment of all rents paid under the lease.
- The lease between the Eligible Passive Company and the Operating Company, including options to renew exercisable solely by the Operating Company, must have a remaining term at least equal to the term of the loan. Lease payments may not exceed the combined total of loan payments and EPC's other expenses of holding the property, such as insurance and property taxes.

- The Operating Company must be a co-borrower (with the Eligible Passive Company) of the loan if the loan includes working capital.
- **Each** 20 percent or more owner of the Eligible Passive Company and **each** 20 percent or more owner of the Operating Company must guarantee the loan (the trustee shall execute the guarantee on behalf of any trust).
- **Each** 20 percent owner of the Eligible Passive Company and **each** 20 percent or more owner of the Operating Company must meet the personal resource rules discussed in the prior section, “Utilization of Personal Resources”.

Additional conditions apply to trusts. The eligibility status of the trustor will determine trust eligibility. All donors to the trust will be deemed to have trustor status for eligibility purposes. A trust qualifying as an Eligible Passive Company may engage in other activities as authorized by its trust agreement. The trustee must warrant and certify that the trust will not be revoked or substantially amended for the term of the loan without the consent of SBA. The trustor must guarantee the loan. The trustee shall certify to SBA that:

- The trustee has authority to act;
- The trust has the authority to borrow funds, pledge trust assets, and lease the property to the Operating Company;
- The trustee has provided accurate, pertinent language from the trust agreement confirming the above; and
- The trustee has provided and will continue to provide SBA with a true and complete list of all trustors and donors.

Exercise: Take a few minutes to answer questions related to EPC/OC situations described below. Answers can be found in 1-A.

EPC/OC Case

Ready Constructors, Inc. Loan Officer’s Credit Memorandum

Eligibility: The applicant is a mechanical contractor. The firm is currently located in two places, and it is constructing an 8,000 square foot office and warehouse facility in Tampa, FL. Ready Constructors will occupy 100% of the new building.

The land will be purchased by Joseph and Mary Jones. Joe Jones founded Ready in 1952, and retired in 1990, after selling the business to the current owners Gabriel Lopez and Michael Angel. Joe and Mary will lease the real estate to Ready on a 20-year lease-to-purchase contract. Purchase cost will be nominal at lease maturity. This will be constructed as an “Eligible Passive Company” loan to Joe and Mary.

Project Summary:

Purchase land	\$99,700
Construction costs	<u>305,300</u>
Total	405,000
Bank Loan	\$365,000
Owner injection	<u>40,000</u>
Total	405,000

Owner injection is from Joe Jones, who is purchasing real estate and will construct the building (Butler Building) on the land. Lender policy prevents loan approval for an owner who is not the occupant. Therefore, the SBA guaranty is necessary and the deal will be structured as an EPC/OC.

Moving costs of \$25,000 will be funded from a new bank line of credit to Ready.

History and Management: Ready Constructors, Inc. was founded in 1952 by Joseph Jones. He retired in 1990, but continues to work on an hourly basis at the company. Lopez and Angel each own 50% of the current firm. The company does mechanical contracting and specializes in heavy commercial piping, plumbing, and complex HVAC projects.

Balance Sheet: The company, after adjusting for the proposed transaction, has a debt to worth of 3.71 compared to the industry average of 1.4. Prior to the transaction, the ratio was 2.49. This was after discounting \$46,400 in officer loans. The current ratio of 1.30 compares to the industry average of 1.60.

Accounts receivable, including retentions, turn in 52 days compared to an industry average of 57 days. Accounts payable turn in 51 days compared to an industry average of 33 days.

The company's bank debt consists of a term note on equipment with a balance of \$116,700 and a credit line with a current balance of \$70,400. Both notes have been handled as agreed, and are current.

In addition to fixed costs, the business will require an additional \$25,000 for moving expenses. Lender will provide this additional \$25,000 as an addition to the current revolving note of \$70,000. It is secured with a chattel lien on accounts receivable and inventory.

Repayment Ability: Based on actual results for the most recent fiscal year, the business shows a debt service coverage of 1.49. Based on the prior fiscal year results, coverage is even greater at 1.95. Management states that lower earnings in the most recent fiscal year are attributable to the start-up of the sheet metal division. That division was reorganized in the current year and is now profitable.

Collateral: The collateral for this loan will be a first deed of trust on an 8,000 square foot office/warehouse facility in Tampa. The property is expected to appraise for \$400,000 resulting in a collateral coverage of 1.21. The collateral appears adequate to protect the lender's interest.

Credit History: The bank has checked several credit sources; all reveal no problems. They include TRW, Dun and Bradstreet, and several trade creditors. The company has been a customer of the bank for 10 years. All relationships have been handled as agreed, and the business maintains an account balance in the low \$100,000s.

Recommendation: Customer is a well-established small business with good track record and demonstrated repayment ability. The credit meets lender policy guidelines except for the land-lease situation. Since the primary landowner is not the business, the SBA guaranty mitigates this policy exception.

Loan officer recommends approval.

EPC/OC Questions

1. Who is/are the borrower(s)?
2. What components are important in the size standard determination?
3. What other requirements would be necessary?

FRANCHISES

Franchises, including license, membership or distributorship agreements are **eligible** except in situations where a franchisor retains power to control operations to such an extent as to be tantamount to an employment contract. The franchisee must have the right to profit from efforts commensurate with ownership.

To streamline its review of franchise eligibility, SBA has established a Franchise Registry. Participation in the Registry is voluntary. The Registry will list those franchisors and franchise programs whose standard franchise documents comply with SBA eligibility requirements. All lenders may use the Registry in their loan processing.

Lenders can access the Registry at www.franchiseregistry.com to see if the franchise is approved. If the franchise is listed on the Registry as eligible for SBA financial assistance, the application must include one of the following certifications:

1. A Certification of No Change (see Appendix 1-D) stating there are no changes in the franchisor's franchise documents in any way relevant to SBA's eligibility guidelines since the initial registration or last revision date in the Registry; OR
2. A Certification of Change (see Appendix 1-E) listing all relevant changes.

If the franchise is not listed, the FTC disclosures, franchise agreements, et al, must be submitted to SBA for review & approval prior to loan approval. To expedite processing, lenders may submit these documents to SBA prior to submission of the loan application.

RECREATIONAL FACILITIES AND CLUBS

Recreational facilities and clubs are **eligible** provided: (a) the facilities are open to the general public or (b) in "membership only" situations, membership is not selectively denied any particular group of individuals and the number of memberships is not restricted either as a whole or by establishing maximum limits for particular groups.

CHANGE OF OWNERSHIP

SBA may finance a total change of ownership when the change will: (1) promote the sound development of a small business, or (2) preserve the existence of a small business.

Change Of Ownership Considerations

- Arm's-Length Transaction

Loan proceeds may only be used to effect a change of ownership that is an arm's-length transaction. A transaction is at arm's length if it is a reasonable representation of the fair market value, the price that an independent buyer would be willing to pay.

The seller should receive no other benefit than the funds obtained from the sale, including interest in the event there is seller financing, and the purchaser should receive no other benefit than the right to own and operate the business and receive a profit commensurate with this operation.

To determine whether the change of ownership qualifies as arm's-length, a determination of the value of what is being acquired must be performed. When the change of ownership involves the acquisition of a going concern, the determination must be based on a generally accepted valuation method used for the industry in which the business operates. Four acceptable valuation methods include:

- the gross revenue multiplier,
- adjusted book value,
- discounted future earnings, and
- capitalized adjusted earnings.

Other generally accepted valuation methods may also be employed. The analysis can be performed by the loan officer or an independent person qualified, in the opinion of SBA, to perform business valuations.

The analysis and a synopsis of the determination must be provided SBA as part of the application. A formal valuation performed by an independent and qualified person, is always required when the change of ownership occurs between close family members.

- Reasons for the Sale

The loan analysis should clearly explain the reasons for the sale. Is it to permit the current owner to retire or leave because of poor health? Is it really to avoid something adverse such as a new competitor about to open or highway construction that will severely restrict access to the business?

Careful analysis of the financial statements needs to be conducted. Note any trends and consider local conditions. Is the area growing or decaying? Is the buyer presently an employee of the firm who already knows the market or is the buyer an inexperienced newcomer?

- Documentation for a Change in Ownership Case

In order to process a change of ownership application, the proposed instruments of conveyance (generally the buy/sell agreement) must be present and they must be analyzed. The pro forma balance sheet shall be prepared to reflect what the business will look like on the date ownership transfer occurs. The selling price must be compared to the value of the business after the value has been determined from an independent third party. Said valuation must be obtained prior to approval or disbursement. The fact that the purchasing and selling parties have agreed to a selling price is not adequate justification that the business is worth that much. The price must be substantiated by recognized methods of value determination.

Financial statements of the business or division being purchased are required whenever the demonstration of repayment is based in part or in full upon the historical performance of this business, regardless of how the actual change of ownership will be accomplished.

- Acquire a Going Concern

When a change of ownership involves the acquisition of a going concern, the applicant's repayment ability will be based, at least in part, on the historical performance of the former company, regardless of whether the actual change is accomplished via a stock purchase or asset purchase.

When repayment is based on the historical performance of the whole company, business operation, or the collection of assets acquired with loan proceeds, the historical financial statements from the seller, for no less than the last 3 complete fiscal years plus interim statements, which are no older than 90 days from receipt of application, will be required.

- Acquire Assets

When a change of ownership involves the acquisition of another business's assets without affecting a change in the operation status of the selling business and the repayment ability of the loan will be based in full on the performance (historical and/or projected) of the buyer, rather than in any part on the historical performance of the seller, the need to obtain or verify the seller's historical financial statements is not necessary.

The value of the assets needs to be substantiated. Therefore, a valuation conducted by an independent third party must be obtained prior to approval or prior to disbursement.

Note: When the purpose of the loan is to acquire the assets of another business and repayment will not be based on how well these assets performed for the seller, the historical financial statements of the business that is selling the assets do not have to be part of the application submission and do not have to be IRS verified.

Additional Consideration for Changes Between Family

SBA can finance a change of ownership when there is a close relationship between the buyer and seller, such as close family members, but these situations require extra caution.

You must be sure that the transaction is arm's-length. The value of the business must be clearly substantiated. The purchase price must be based on an independent third party valuation and you must closely evaluate current and historical financial statements and tax returns to insure they are accurate. Change of ownership loans between close family members require the determination of the value of what is to be acquired (assets or going concern) to be independently valued. An independent third party appraisal or valuation is needed. For this type of loan, the appraisal must be completed prior to processing. A change of ownership between close family members cannot be approved on a "subject to" appraised value or independent valuation. This requirement can not be waived.

Partial Change in Ownership

The allowable structures for permitting a change of ownership of an existing business depends upon the relationship of the buyer and seller to the business whose ownership is scheduled to change when the sales contract is consummated. Under no circumstances can proceeds be used to finance a borrower's purchase of only a portion of the ownership interests of the present owners.

If the buyer is presently an owner (any percentage) of the company whose ownership interest is being sold, loan proceeds can only be used to purchase 100 percent of the ownership interest of that owner, partner, or shareholder, providing this change of ownership will result in the sound development or preservation of the business and the loan is made to the company. This can be accomplished through redemption of stock by a corporation or through the purchase of a partner's interest by the partnership. There can be no purchase directly by a partner, shareholder, or an unrelated third party in this situation.

If the buyer is not an owner of the company being sold, the loan proceeds must be used to purchase 100 percent of the ownership interest of all owner(s), partner(s), or shareholder(s), and the change of ownership must result in the sound development or preservation of the business. In this case, there can be no purchase directly by an existing partner or shareholder.

When a change of ownership occurs between existing owners, the proceeds must be lent to the business in order for the entity to either redeem (acquire) the stock of the selling shareholder for a corporation, or acquire the selling partner's interest for the partnership. No proceeds can be provided to any one or group of stockholders or partners to acquire any other stockholder or partner interest directly.

When a change of ownership occurs between unaffiliated parties, the loan is made to the business entity of the acquiring party and the proceeds must be used to purchase the entire ownership interest of all the partners or shareholder(s) of the company being acquired.

In any case, the purchase must result in the sound development or preservation of the business.

Additional Considerations for Businesses That Have Been Transferred within 36 Months Prior to the Date of the Loan Application

In August 2000, SBA issued a Policy Notice that changed the requirements for valuation of businesses when the business has been previously sold within 36 months of the date of the application. The new procedure is as follows:

Business valuations (going concerns): Lenders must use at least two valuation methods to establish a range of values for the business. Refer to the “How to Value a Business” portion of the Processing section of this manual for guidance on the accepted methods of valuation.

Real Estate Appraisals: If the value of the real estate is over \$100,000, two appraisals are required, including one requested directly by the lender. Lenders have the option of replacing the second appraisal with one of the following:

- a. A “review” of the first appraisal by another appraiser (selected directly by the lender),
OR
- b. If the first appraisal was requested by the lender, a site visit by a senior member of the lender’s staff may be substituted for the second appraisal. The lender must document the file and include the date of the visit and a description of the items reviewed on site.

100 Percent Purchase of Corporate Stock

A change of ownership may be financed through the purchase of 100 percent of the capital stock. This policy applies whether:

The acquiring party is a current owner(s) of the business buying out 100 percent of the interests of one or more of the shareholders, OR

The acquiring party owns no stock of the business being acquired and is purchasing 100 percent of the capital stock of the corporation from the existing owner(s), as long as the result of the loan is that the acquiring entity owns 100 percent of the business. The acquiring party may be an individual or any other legal entity.

If a change of ownership is to be accomplished through the purchase of corporate stock, the existing company must buy all of the stock of the departing shareholders or a third party must purchase 100 percent of the stock from all the existing shareholders. In either case, both the purchaser(s) of the stock and the new corporation must sign the note with joint and several liability for the parties. The requirement for personal guarantees and utilization of personal resources will only apply to the principals of the acquiring entity, not the principals of the selling entity.

A corporation may also change its ownership by repurchasing (a/k/a/redeeming) 100 percent of the shares of stock of one or more of its shareholders. If counsel determines it is required under state law, the authorization will contain a provision requiring an opinion of lender's or borrower's counsel that the stock repurchase will not violate applicable state law (such as by rendering the corporation insolvent).

In each case, both the individual who acquires the stock and the corporate entity being acquired must execute the note on a joint and several basis. Both should represent to SBA that the proceeds of the loan will be used in connection with the operation of the business itself. The requirement for personal guarantees applies only to principals of the acquiring entity, not to principals of the corporate entity being acquired, even though the corporate entity being acquired will be a co-borrower.

Legal Considerations

To protect against the possibility that the corporation may deny its joint and several liability with the acquiring party based on an alleged failure of consideration, the purpose of the acquisition must be to enable the acquiring party to operate the business in corporate form.

If SBA field counsel determines that there is risk that a corporation will deny liability for its joint and several liability with the acquiring party based on an alleged failure of consideration, add an Authorization provision acceptable to field counsel that:

- (1) Requires a satisfactory opinion from the borrower's or lender's counsel that the corporation has no basis for denying liability for the debt for failure of consideration;
OR
- (2) Requiring a waiver of the corporation of any right to deny liability for the debt for failure of consideration.

The following chart outlines scenarios of eligible and non-eligible partial changes of ownership. These examples all involve proposed exchanges in ownership interest in order to accomplish a change in the ownership of the applicant concern.

Proposed Action	Buyer Affiliated with Seller	Buyer Not Affiliated with Seller
Individual wants to buy all of an existing SBC.	Loan must be to a SBC. All other owners must sell 100 percent of their interest. Proceeds used to redeem full ownership interest of each selling owner.	Loan to buyer or entity established by buyer. Proceeds used to buy 100 percent of each existing owner's interest.
Individual wants to increase their ownership in an existing SBC.	Loan must be to an SBC. At least one owner must be selling full interest. Proceeds used to redeem full ownership interest of each selling owner. All remaining owners will have a new ownership interest that is in the same proportion to each other as existed before the loan.	N/A
Individual wants to buy out one of any number of owners and increase just his/her interest to a greater share in relation to the other owners.	Not Permitted - SBA does not finance "Creeping Control."	N/A
Company with more than one owner wants to allow the non-owner manager a chance to buy a retiring owner's interest and let the other owners remain status quo.	Not Permitted - Under SBA rules, when a non-owner will become an owner, all (100 percent) existing owners have to sell their interest.	Not Permitted
Individual wants to buy out one of any multiple number of owners in a company he does not own.	Not Permitted - Under SBA rules, when a non-owner will become an owner, all (100 percent) existing owners have to sell their interest.	Not Permitted - Because an unaffiliated buyer can only acquire all of an SBC, not any portion.
Sole proprietor wants to form a new partnership and take on a partner who has worked for his company.	N/A	Not Permitted - An owner cannot give up a portion of his/her ownership to a non-owner.
Existing owner wants to use SBA proceeds to acquire one half of another owners interest.	Not Permitted - SBA does not finance "Creeping Control."	N/A

FARMS AND AGRICULTURAL BUSINESSES

Farms and agricultural businesses are **eligible**. However, these applicants should first be referred to Rural Development (formerly Farmers Home Administration) programs, particularly if the applicant has a prior or existing relationship with that Agency.

FISHING VESSELS

Fishing vessels are **eligible**. However, those seeking funds for the construction or reconditioning of vessels with a cargo capacity of five tons or more **must** first request financing from the National Marine Fisheries Service (NMFS), a part of the Department of Commerce. Loans for another purpose may be considered without the applicant's having first applied to NMFS.

MEDICAL FACILITIES

Hospitals, clinics, emergency outpatient facilities, medical and dental laboratories are **eligible**. Convalescent and nursing homes, i.e. Adult Living Facilities (ALF), are **eligible** provided they are licensed by the appropriate government agency and services rendered go beyond those of room and board.

BUSINESS LOCATED IN A FOREIGN COUNTRY OR OWNED BY ALIENS

A business located in a foreign country with no activities in the United States is ineligible for SBA financial assistance. Businesses with both domestic and foreign locations/operations cannot use SBA loan proceeds to benefit the foreign location/operation. Foreign-owned businesses that operate in the U.S. are subject to other special requirements. Businesses owned by illegal aliens are ineligible. Businesses involved in international trade are subject to U.S. trade restrictions.

To be eligible, an applicant must have a place of business located in the U.S.; must operate primarily in the U.S. and be authorized to operate in the state where they seek SBA financial assistance; pay taxes to the U.S.; use American products, materials and labor; and the proceeds must be used exclusively for the benefit of the domestic operations. As a result, the business and its employees are subject to U.S. and local taxes.

The “United States” includes the 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Territories and Possessions, and the Trust Territory of the Pacific Islands.

The following restrictions are placed on businesses with “foreign” elements:

- Restriction on Foreign Located Businesses: An applicant with no place of business in the United States is not eligible. An American subsidiary of a foreign-owned business is not ineligible if it is authorized to operate in the state or territory where it intends to conduct its operations.
- Restrictions on Domestic Businesses with Foreign Operations: U.S. owned businesses that conduct operations in both the U.S. and elsewhere cannot receive loan proceeds that benefit the foreign operations. This means the proceeds must be used exclusively for the benefit of domestic operations.
- Small Businesses Owned by Foreign Nationals or Foreign Entities: A small business owned by a foreign national or a foreign entity must have a place of business located in the United States and must comply with the requirements detailed in the opening paragraphs of this section. In addition, businesses owned by foreign nationals or foreign entities are subject to the same requirements as those imposed on businesses owned by persons with temporary visas as discussed later in this text.
- Restrictions on Businesses Owned by Undocumented (Illegal) Aliens: SBA is prohibited from provided financial assistance to illegal aliens.

- Restrictions on Businesses Involved in International Trade: Businesses that trade internationally are subject to the trade restrictions imposed by the U.S. Government. SBA cannot provide financial assistance to any business that conducts prohibited commercial activity with a country identified by the U.S. Government, even if the proceeds would only benefit domestic operations.

Whenever an applicant indicates that they conduct international trade, the lender or CDC must verify that the U.S. Government does not restrict trade with any country where the applicant does business. Verification consists of reviewing the Export-Import Bank's current "Country Limitation Schedule" (CLS). When an applicant conducts commercial trade in a country that the list identifies as unlawful with which to trade (referenced on the CLS as footnote #7), the application is not eligible and cannot be accepted for processing, even if the purpose of the proceeds is to finance a transaction to a non-restricted country.

The CLS lists all countries with which commercial activity is unlawful. The lender should document this in writing. However, if the lender tells SBA orally instead of in writing, SBA must document the oral statement in the case file. The CLS is made available by Ex-Im Bank and is updated as needed or annually. A current schedule can be obtained via the internet address: http://www.exim.gov/tools/country/country_limits.html.

SBA can provide financial assistance to businesses that are owned by persons who are not citizens of the United States. However, the processing procedures and the terms & conditions will vary, depending upon the status of the owners assigned by the Immigration and Naturalization Service (INS).

Definitions of Immigration and Naturalization Service (INS) Statuses:

Naturalized Citizens are persons of foreign birth who have been granted citizenship in the U.S. These individuals are not subject to any special restrictions or requirements. If an individual's SBA Form 912, Statement of Personal History, reflects s/he is a U.S. citizen, no further verification of status is required.

Legal Permanent Residents (LPR or immigrant a/k/a Permanent Resident Aliens) are persons who may live and work in the U.S. for life unless INS revokes this status through an administrative hearing. INS revokes LPR status and deports aliens when they are convicted of criminal activity, normally a felony. Therefore, immigrants with felony convictions are not eligible unless:

1. INS provides written documentation, identifying the specific criminal activity, stating that the LPR status is in good standing, in spite of the specific documented activity, AND
2. AA/FA or designee authorizes processing of this application.

Asylees and Refugees are persons considered political offenders by their country or are fleeing war or similar conflict who receive temporary refuge in the U.S. Asylees and

refugees do not automatically receive LPR status. They must apply for this status like any other alien.

Non-Immigrant (Documented) Aliens are persons who are admitted to the U.S. for a specific purpose(s) and for a temporary period of time with a current/valid INS document such as a visa.

Undocumented Aliens are persons in the U.S. illegally.

Foreign Nationals are non-citizens of the U.S. who reside outside the U.S. and do not have an express right, via INS documentation such as a visa, to physically be within U.S. boundaries.

Foreign Entities are businesses, organizations, associations, etc. based in another country.

INS Documentation to Evidence an Alien's Status: SBA Form 912, "Statement of Personal History", requires that aliens provide their alien registration number. An alien registration number indicates that the person is in the U.S. legally. It is not evidence of INS status or eligibility for SBA's programs.

Any alien who must complete SBA Form 912 or who owns 20 percent or more of the applicant business must provide current/valid INS documents to lenders or CDCs to determine eligibility. SBA, lenders and CDCs must place a photocopy of the individual's documentation in the case file.

For questions regarding status, you should contact INS directly. A list of INS offices and suboffices can be found at <http://www.immigration.gov/graphics/fieldoffices/index.htm>.

Verification of INS Status: Because fraudulent INS documents are a serious problem, lenders and CDCs must verify the INS status of each alien, including LPRs who are required to submit INS documents. You must document the findings in the application package. This applies in all cases, regardless of the processing method or loan program.

SBAExpress is the only exception to the requirement. For loans submitted under *SBAExpress*, verification of alien status must be completed prior to making any disbursements.

The lender or CDC must submit an INS Form G-845 (845), "Document Verification Request", with supporting information to the nearest INS office. INS releases information about the status of an alien to lenders or other non-governmental entities ONLY when a signed and dated authorization from the alien is attached to and submitted with the Form G-845 on that alien. INS requires that authorizations provide the person's name, address, and date of birth. INS accepts either of the following authorization statements:

I authorize the Immigration and Naturalization Service to release information regarding my immigration status to [name of lender/CDC], because I am applying for a U.S. Small Business Administration loan. OR

I authorize the Immigration and Naturalization Service to release alien verification information about me to [name of lender/CDC], because I am applying for a U.S. Small Business Administration loan.

Without this additional language, INS will not respond to the lender or CDC. It is also important not to abbreviate U.S. Small Business Administration. Individuals should submit the request on personal stationary and must not submit this statement on SBA or lender/CDC letterhead.

INS requires a “wet” signature on all Freedom of Information Act requests. Therefore, the Form G845 and the statement authorizing INS to release the status information to the lender or CDC should never be faxed to an INS office.

Legal Permanent Resident-Owned Small Businesses: The primary document acceptable as evidence of LPR status is INS Form I-551 (551). INS has two versions of the 551. One is titled “Resident Alien Card”. The other is titled “Permanent Resident Card”. The latter is the most recent version of the 551.

INS requires replacement of the 551 every 10 years to update the photograph and security measures. Replacement may also be necessary if the 551 is lost, the individual changes name, etc. LPR status does not lapse and is not in jeopardy merely because the 551 document lapses.

Replacement may take more than a year. Acceptable forms of evidence when the 551 has been submitted to INS for replacement or has an expired date include the following:

A temporary stamp by INS on the individual’s passport that says “Processed for I-551 - Temporary Evidence of Lawful Permanent Residence”.

INS Form I-327, “Re-entry Permit” issued to LPRs in lieu of passports, which is valid for only 2 years.

INS Form I-797, “Notice of Action”, a receipt issued to an alien when the 551 is lost or surrendered for renewal or changes (e.g. a name change because of marriage or divorce).

SBA requires that the 551 or an acceptable substitute must be current at the time it is submitted with an application. SBA will return the application without accepting it for processing if the INS documentation is not currently in force.

Small Businesses Owned by Foreign Nationals or Foreign Entities: To be eligible, an applicant small business owned by a foreign national or a foreign entity must have a place of business located in the U.S.; operate primarily within the U.S.; pay taxes to the U.S.; and use American products, materials, and labor. As a result of this, the business and its employees are subject to U.S. and local taxes.

Businesses Owned by Non-immigrant Aliens Residing in the U.S.:

Businesses owned by documented aliens may be eligible. They must have current/valid INS documentation permitting them to reside in the U.S. legally. The documentation/status of each alien must be verified with INS.

Businesses owned by undocumented (illegal) aliens are not eligible for SBA assistance.

Businesses owned by aliens who are subject to the Immigration Reform and Control Act of 1986 (IRCA) might be eligible under limited circumstances. IRCA invests INS with the authority to grant illegal aliens lawful temporary resident status under its provisions. Some aliens already enjoy this status. INS can grant it to others in accordance with the provisions of IRCA.

IRCA prohibits financial assistance to businesses owned 20 percent or more by such individuals for a period of 5 years after INS grants the alien lawful status.

This disqualification does not apply to Cuban or Haitian entrants or alien entrants subject to IRCA who are aged, blind, or disabled. The definition of blind or disabled is equivalent to SBA's criteria for determining eligibility for assistance to any small business owned by disabled individuals.

All applicants self-certify that they are eligible under IRCA by certifying that they have received and read SBA Form 1261, "Statements Required by Law and Executive Orders". This form includes a certification that IRCA does not apply to them.

Additional Requirements for Small Businesses owned by foreign nationals, foreign entities, and non-immigrant aliens residing in the U.S. (Immigrants (LPRs) are the ONLY class of aliens residing in the U.S. eligible to obtain financial assistance from SBA without complying with the requirements stated this section.):

Businesses and their owner(s) in this category must comply with Appendix 3, "Restrictions on Foreign Controlled Enterprises", of SOP 50-10(4). They MUST also meet the following:

1. Provide evidence that separate continual and consistent management (in addition to the owners) exists and will continue indefinitely. The management must have a U.S. citizenship or verified LPR status. The potential for absentee ownership is much greater for businesses in this category. Management must have operated the business for at least 1 year prior to the application date. The application must contain assurance that management is expected to continue in place indefinitely. This requirement prevents financial assistance to "start-up" businesses owned by aliens who do not have LPR status. The personal guarantee of management must be considered as a loan condition and if not required, the loan report must explain why. AND
2. Pledge collateral within the jurisdiction of the U.S. sufficient to pay the the loan any time during its life [based on SBA's definition of collateral as discussed in Subpart A, Chapter

4, Paragraph 1H in SOP 50-10(4)]. This requirement is mandatory for reasons of eligibility for these types of businesses for the life of the loan. However, the credit decision on these applications must be based primarily on repayment ability and other credit factors, not collateral. All Authorizations for loans to alien (other than LPR)-owned and foreign-owned small business must include this requirement.

Note: In order for a business not to be subject to these additional requirements, it must be at least 51 percent owned by individuals who are U.S. citizens and/or who have LPR Status from INS and control the management and daily operations of the business.

See Appendix 1-F for a sample INS Verification Form. The response from the INS generally takes 6 weeks so we recommend you mail the form prior to sending the application to the SBA.

LITIGATION

In the event a loan application discloses the existence of pending litigation, it would expedite the review process to have the Borrower furnish the following:

- A copy of the complaint and answer that has been filed
- An explanation from the Borrower as to the nature of the litigation.

BANKRUPTCY

In the event a loan application discloses the existence of a prior bankruptcy or the applicant is currently in bankruptcy, it will expedite the review process to have the Borrower furnish the following:

- An explanation from the Borrower as to the circumstances that caused the bankruptcy
- If completed, a copy of the discharge
- If ongoing, a copy of the plan, if any

PROBATION OR PAROLE: Applications **will not** be accepted from firms where a principal (any one of those required to submit an SBA Form 912, "Statement of Personal History"):

- is currently incarcerated, on parole, or on probation
- is a defendant in a criminal proceeding
- whose probation or parole is lifted expressly because it prohibits an SBA loan.

Affirmative response to Questions 7 or 8 on SBA Form 912: These judgments are made on a case by case evaluation of the nature, frequency, and timing of the offenses.

If yes to Question 7:

- Furnish details in a separate exhibit, including dates, location, fines, sentences, etc., whether misdemeanor or felony, dates of parole/probation, unpaid fines or penalties, names under which charged, and any other pertinent information.
- Complete a "Supplemental Affidavit to SBA Form 912, Statement of Personal History" (see Appendix 1-G for a copy of a "Supplemental Affidavit" and a copy of "Details of Offense").

If yes to Question 8, also furnish the following:

- Fingerprint cards, Form FD 258 (available from the local SBA office). [Fingerprints are a prerequisite to processing a loan application.]
Please submit fingerprint cards in advance to expedite loan processing.

The FBI cannot process fingerprint cards with highlighted fields or fingerprint cards that have been perforated with any type of hole puncher; therefore, do not highlight any areas of the fingerprint cards or perforate them.

An affirmative response does not necessarily preclude a loan to a business.

STUDENT/GOVERNMENT LOANS

An SBA loan cannot be processed if principals have any delinquent student or other direct government/government guaranteed loans.

DELINQUENT CHILD SUPPORT

An SBA loan cannot be processed if principals who own 50% or more of the company are delinquent more than 60 days under the terms of any administrative order, court order, or repayment agreement that requires payment of child support.

PIGGYBACK FINANCING

What is a Piggyback Financing Arrangement? Piggyback financing occurs when more than one loan is made to a single borrower at or about the same time, for the same or similar purpose, and SBA guarantees the loan secured with a junior lien position. The same lender normally makes both the first and second lien position loans, but this is not a requirement for SBA to consider the structure to be piggyback financing. Therefore the senior position loan may or may not be made by the same lender who makes the subordinate position loan guaranteed by SBA. As a matter of policy, piggybacks are eligible for SBA financing.

Commonality of purpose for the two loans is the key determinant when deciding whether a piggyback structure exists. Examples of when two loans are not considered to be in a piggyback financing arrangement:

1. The SBA second mortgage loan for building improvements, made 3 years after another loan financed the same real estate's purchase;
2. The SBA second mortgage loan for working capital, made at the same time the lender is financing the purchase of real estate;
3. The SBA working capital loan, under a Line of Credit program, secured by both a first position on current assets and second on real property. A remote exception to this example would be when the line of credit was used to finance long term assets.

What are the Underlying Reasons for a Piggyback Structure? A large financing need may lead the lender to consider a piggyback structure in order to obtain the best possible collateral and guaranty position. If \$2,000,000 funding is required, a lender could request a maximum guarantee of \$1,000,000 with a 50 percent guaranty percentage which would leave an unguaranteed exposure of another \$1,000,000. On the other hand, a piggyback with a \$500,000 first and a \$1,500,000 SBA guaranteed second would result in an exposure of \$500,000 in a second and \$500,000 in a first. The lender's exposure is still \$1,000,000, but its risk is reduced or possibly eliminated because of its senior position on the collateral. In this case, a larger first would also reduce SBA's guaranty fee. In short, a piggyback structure generally reduces a lender's risk.

Are there any Eligibility Concerns in a Piggyback? Yes. When the piggyback financing involves refinancing, the purposes of the piggyback loans must be the same or similar. The proceeds of both the guaranteed and non-guaranteed loans must both be eligible for SBA refinancing, as a matter of policy. If the intended use of proceeds for the first position loan are not eligible for SBA refinancing, they are not eligible for refinancing in a senior position loan within a piggyback structure.

Example - Two debts are to be refinanced. The SBA is asked to guarantee a loan in second position where the proceeds will refinance a debt that is eligible for refinancing under SBA

policy and the lender will refinance in a senior position another debt that does not meet the 20 percent cashflow requirement for refinancing. This proposed structure would not be eligible.

How Does SBA View Piggyback Financing? The Agency has always been able to participate in a portion of the overall financing when there are two loans, only one of which will be guaranteed. Thorough credit and risk analysis and the exercise of prudent credit judgment are very important in these instances.

What Characteristics Are Important? Piggyback financing may help applicants obtain the additional credit they need. It also complies with the intent of the credit elsewhere policy. However, SBA's collateral position is weaker when it has a junior lien position, particularly if additional collateral is not available. The terms of the non-guaranteed loan may have a significant impact on the ability of the borrower to repay the guaranteed loan, particularly when balloon or call provisions are imposed.

Requirements Imposed on the First Position Lender: For its participation in a piggyback structure, the SBA requires that the lender agree to certain terms and conditions. If the first position lender does not agree, the piggyback second position loan cannot be authorized. This is the case regardless of whether the first and second position lenders are the same or different.

The first position lender must waive any provisions in its note or loan documents that:

1. Allow future advances except advances made for the reasonable costs of collection, maintenance, and protection of lender's senior lien.
2. Cross-collateralize the loan with other non-SBA financings provided by lender to borrower.
3. Have an early call feature.
4. Are payable on demand unless the lender's note is in default.
5. Contain a default interest rate, a late payment charge, or a prepayment penalty which is not subordinate to the lender's position on this loan.

The first position lender will subordinate any senior lien prepayment penalties, late payment charges, or increased default interest to this loan. Any advances made for reasonable costs of collection, maintenance, and protection of lender's senior lien need not be subordinated. If such subordinated amounts are paid to the lender through purchase of the senior lien, foreclosure, or consensual sale, the lender agrees to apply such funds to this loan.

Exercise: Take a few minutes to answer questions related to piggyback financing in the situations described below.

1. Borrower is acquiring real estate and machinery to relocate his business. The participant lender approves a 1st mortgage loan on real estate for a \$500M non-SBA loan. The lender also approves a \$200M SBA loan for machinery and equipment presuming a 1st lien on all fixed asset chattels which includes other equipment that "fully secured" the loan per SBA standards. Is this loan considered a piggyback arrangement?

2. In the same situation, as problem one, the lender takes a 1st lien on **all** collateral to secure the \$500M non-SBA loan, and takes a 2nd position on all collateral, including the real estate, to secure the \$200M SBA loan. Is this considered a piggyback arrangement?
3. A lender approves a \$200M non-SBA revolving credit line loan to a business with all current assets as collateral. That same lender also approves a \$400M fixed asset SBA loan with a 1st lien on all fixed assets. The general purpose of both loans is expansion of the business production capabilities. Is this considered a piggyback arrangement?
4. In problem 3 above, lender further “cross-collateralizes” each loan by filing a position behind the other loan in **each** case. Is the considered a piggyback arrangement?

APPENDIX 1-A

ANSWERS TO CHAPTER 1 EXERCISES

Credit Elsewhere Exercise

1. Yes. Credit on terms requested and needed by the business are not available from the lender given current lender policy.
2. No. SBA lending rules focus on the business as the borrower. The business does not own the real estate and cannot pledge it, so credit is not available elsewhere from business resources.

NOTE: A few words of caution. SBA's policy states that a personal residence is taken when the lender requires it; or, when other collateral is weak and the equity is at least 25% or greater; or, when the property is the business premises. Personal residences should not be taken just because they exist. There may or may not be a case for requiring the principal's residence as additional collateral in this scenario. If business historical earnings are strong, collateral offered is reasonably sufficient per SOP direction, and the lender does not ask for a mortgage, SBA requirements for a 2nd mortgage in the above instance would not be mandatory.

3. Yes. SBA would require a mortgage on the building as reasonable collateral. If the borrower is unwilling to pledge it, the loan would be declined. Since the lender is willing to provide financing using the real estate, then credit is available elsewhere on reasonable terms to the business.
4. No. The lender has not met the test. The evidence is clear. Another lender has approved the long term financing without an SBA guarantee, even though that loan apparently is not disbursed. This is clear evidence of credit available elsewhere and not eligible for an SBA guaranty.

NOTE: If the information had been anecdotal or speculative only, SBA does not require one lender to make a credit elsewhere determination on anecdotal information about another lender's credit policies. But, this was not a hearsay situation; this was factual and identified in Lender's credit memo.

Liquid Personal Resources Exercise

1. What is the total Financing package?

Refinancing of current 1 st mortgage	\$500,000
Construction of new building	\$1,225,000
Inventory Purchase	\$100,000
Storage Racks	\$75,000
New vehicles	\$100,000
 Total Financing Package	 \$2,000,000

2. What individuals come under the liquid personal resource provisions of the SOP?

Robert Price and Mary Price (one family unit)
David and Jane Price and David Price II (one family unit)
George Benderson

Henry is not to be considered under the Personal Resource Provision since he is of majority age and has no interest in the business.

3. What assets of the individuals must be considered liquid and available under the provision, and how much will they be mandated to contribute?

Robert	
CDs	\$750,000
Savings	\$225,000
Mary	
CDs	\$750,000
Savings	\$80,000
Total for family unit to be considered:	\$1,805,000

Note: The irrevocable trust need not be considered-because the beneficiary son is of majority age and the trust is irrevocable.

The project financing is for \$2 million. Under SOP guidelines Robert and Mary are allowed one times the financing package to be exempt. Therefore Robert and Mary Price do not have to inject personal resources into the project because they have no excess personal liquid assets.

David	
Liquid Assets	\$19,000
Jane	
Cash	\$55,000
CDs	\$200,000
Marketable Securities	\$750,000

David II	
Cash	\$375,000
CDs	\$800,000
Marketable Securities	\$1,500,000

Total for family unit to be considered \$3,699,000

Under the Liquid Personal Resource Provisions the above assets exceed the allowed exemption by \$1,699,000. David, Jane and David II must inject these excess liquid personal assets of \$1,699,000 into the project.

George Benderson	
CDs	\$90,000
CSV Life Insurance	\$200,000
Marketable Securities	\$350,000

Total to be considered \$640,000

Note: The home, which is free and clear, is not considered in the calculation.

George's liquid personal assets do not exceed the exemption. Therefore, he will not be required to inject any additional assets to meet this test.

4. What will be the amount of the SBA loan request?

The original request was for \$2 million with a first mortgage of \$500,000 and the balance to be financed with a SBA loan of \$1.5 million. Since the liquid assets of David, Jane and David II exceed the exception limit by \$1,699,000 and must be injected, they entirely replace the SBA loan.

Size Exercise

1. Yes. NEC (Not Elsewhere Classified) for service businesses is a \$5.0MM sales per year size standard.
2. Yes. SIC 2841 has a standard of 750 employees.
3. We have already determined each is “small” separately. But what about together?

Determine primary industry; probably the manufacturing operation since it has \$25.0MM sales versus the \$3.2 MM sales for the service business. Sales volume tends to drive the primary industry determination.

Then combine the two businesses under the size standard of 750 employees. Together the businesses employ 770 people. The affiliate group is NOT small.

4. Two possibilities:

If the business is located in a “high unemployment” (labor surplus) area, we can add 25% to the size standard.

If any of the housecleaning employees are also the same employees in the manufacturing firm, we do not need to count them twice. For example, if 20 of the service business employees work only part-time for cleaning service, and the other part of their time for the manufacturer, we could subtract these 20 from the calculation (in order to not count them twice) and this would result in 740 total employees, within the 750 size standard.

EPC/OC Exercise

1. Who is/are the borrower(s)?

This is an eligible EPC/OC situation. The OC is Ready Constructors; the EPC is Joseph and Mary Jones. Joseph and Mary Jones are an “entity” by virtue of their marriage. No d/b/a is necessary.

Joe and Mary must be the direct obligors. Ready must either co-borrow or guarantee; at its discretion.

2. What components are important in the size standard determination?

As the landlord, Joe and Mary must meet the \$5.0 MM annual revenue size standard from all their investments. Assuming this is their only investment, they are “small” based upon their size standard.

Special trade contractors (SIC 1700s) have a size standard of \$7.0 million. Ready is “small” at \$4.47 MM in annual sales for in 1995.

A determination of whether the Jones are “affiliated” with Ready must be made. Just being the landlord DOES NOT make them affiliated. If they are because of some other factor, then primary industry rules must be followed. Primary industry would typically be the larger revenue producer; probably Ready in this instance.

3. What other requirements would be necessary?

- Assignment of rents.
- Determination that rent was not significantly greater than debt service on the loan, plus reasonable maintenance and taxes and insurance. Example: if the monthly debt service was \$7,000.00 a month and the taxes and insurance were \$300.00 per month and the maintenance was \$200.00 per month, the allowable lease payment could be \$7,500.00 per month.
- Personal guaranties of Joe and Mary Jones, Gabriel Lopez and Michael Angel.

Piggyback Exercise

1. No. The purpose is the same, relocation of business, but SBA has no junior lien position to the lender on collateral.
2. Yes. The purpose is the same and the SBA now has a junior lien position to the lender.
3. No. Even if this is considered one business expansion purpose, SBA has no junior lien position.
4. No. SBA still has a clear 1st lien position on the assets it is financing. Lender's credit memo should clearly identify the reason for the cross-collateralization as a prudent lending practice.

APPENDIX 1-B

CALCULATION OF EXCESS PERSONAL RESOURCES

CALCULATION OF EXCESS PERSONAL RESOURCES	
PRINCIPAL NAME:	
	AMOUNT
LOAN AMOUNT	
LIQUID ASSETS	
CASH	
CD's	
SAVINGS	
MARKETABLE SECURITIES	
CASH SURRENDER VALUE OF LIFE INSURANCE	
TOTAL LIQUID ASSETS	\$ -
PERSONAL RESOURCES EXEMPTION	
FOR LOANS \$250,000 OR LESS: \$100,000 OR 2 X THE LOAN AMOUNT, WHICHEVER IS GREATER	\$ -
FOR LOANS >\$250,000 AND <\$500,000: \$500,000 OR 1.5 X THE LOAN AMOUNT, WHICHEVER IS GREATER	
LOANS >\$500,000: \$750,000 OR THE LOAN AMOUNT, WHICHEVER IS GREATER	
EXCESS LIQUID RESOURCES	\$ -

APPENDIX 1-C

13 CFR SIZE STANDARDS AND AFFILIATION REGULATIONS

APPENDIX 1-D

CERTIFICATION OF NO CHANGE OR NON- MATERIAL CHANGE ON BEHALF OF REGISTERED FRANCHISOR

Certification of No Change or Non-Material Change on Behalf of Registered Franchisor

As authorized representative of _____ [Franchisor], I certify as follows:

1. On _____, (the "Registration Date"), the U.S. Small Business Administration ("SBA") listed _____ [franchise program] on its Franchise Registry as complying with SBA's franchise eligibility guidelines.
2. This registration followed SBA's review of a package of documents (the "Franchise Documents") that Franchisor requires its franchisees to sign in order to participate in _____ [franchise program].
3. (Check one of the following):

☐ There have been no changes to the Franchise Documents since the Registration Date or the date of last re-certification.

☐ There have been Non-Material Changes (changes to the Franchise Documents that are not related to SBA's eligibility guidelines and that do not require a change to worksheet responses) since the Registration Date or the date of last re-certification. I have submitted to SBA's contractor, FRANDATA, a copy of this certification, a complete set of the current Franchise Documents, a new worksheet (only if necessary to reflect changes to the Franchise Document), and a redlined set of the Franchise Documents indicating all revisions since the Registration Date or the date of last re-certification.

Name

Date

Authorized Representative of _____ [Franchisor]

APPENDIX 1-E

CERTIFICATION OF MATERIAL CHANGES ON BEHALF OF REGISTERED FRANCHISOR

Certification of Material Changes on Behalf of Registered Franchisor

As authorized representative of _____ [Franchisor], I certify as follows:

1. On _____, (the "Registration Date"), the U.S. Small Business Administration ("SBA") listed _____ [franchise program] on its Franchise Registry as complying with SBA's franchise eligibility guidelines.
2. This registration followed SBA's review of a package of documents (the "Franchise Documents") that Franchisor requires its franchisees to sign in order to participate in _____ [franchise program].
3. The following Material Changes (changes to the Franchise Documents related to SBA's eligibility guidelines that require a change to the worksheet responses) have been made to the Franchise Documents since the Registration Date or the date of the last re-certification:

Document

Section

Page

4. I have submitted to SBA's contractor, FRANDATA, a copy of this certification together with a revised Worksheet, a complete set of the current Franchise Documents, and a redlined set of the Franchise Documents indicating all revisions since the Registration Date or the date of last re-certification.

Name

Date

Authorized Representative of _____ [Franchisor]

APPENDIX 1-F

INS DOCUMENT VERIFICATION REQUEST FORM

Document Verification Request

Section A - to be completed by the submitting agency.

To: Immigration and Naturalization Service

6. Verification Number

7. ☐ Photocopy of Document Attached.
(If printed on both sides, attach a copy of the front and of the back.)
- ☐ Other Information Attached (Specify documents).

From: Typed or Stamped Name and Address of Submitting Agency

8. Organization (specify)

Attn: Status Verifier

(INS may use above address with a #20 window envelope.)

1. Alien Registration or I-94 Number

2. Applicant's Name (Last, First, Middle)

3. Nationality

4. Date of Birth (Month/Day/Year)

5. Social Security Number

9. Name of Submitting Official

10. Title of Submitting Official

11. Date

12. Telephone Number

Section B - to be completed by INS.

INS RESPONSE: From the documents or information submitted and/or a review of our records we find that:

1. ☐ This document appears valid and relates to a **Lawful Permanent Resident alien** of the United States.
2. ☐ This document appears valid and relates to a **Conditional Resident alien** of the United States.
3. ☐ This document appears valid and relates to an alien **authorized employment** as indicated below:
- a. ☐ Full-Time
- b. ☐ Part-Time
- c. ☐ No Expiration
- d. ☐ Expires on _____
(specify Month/Day/Year, below)
4. ☐ This document appears valid and relates to an alien who has an application pending for
(specify INS benefit below)
5. ☐ This document relates to an alien having been granted **asylum/refugee** status in the United States.
6. ☐ This document appears valid and relates to an alien **paroled** into the United States pursuant to Section 212 of the I&N Act.
7. ☐ This document appears valid and relates to an alien who is a **Cuban/Haitian entrant**.
8. ☐ This document appears valid and relates to an alien who is a **conditional entrant**.
9. ☐ This document appears valid and relates to an alien who is a **nonimmigrant**.
(specify type or class below)
10. ☐ This document appears valid and relates to an alien **not authorized employment** in the United States.
11. ☐ Continue to process as legal alien. INS is searching indices for further information.
12. ☐ This document is **not valid** because it appears to be (check all that apply)
- a. ☐ Expired
- b. ☐ Altered
- c. ☐ Counterfeit

INS Stamp

☐ Please see reverse for additional comments.

Comments

13. ☐ No determination can be made from the information submitted. Please obtain a copy of the **original** alien registration documentation and resubmit.
14. ☐ No determination can be made without seeing both sides of the document submitted (*please resubmit request*).
15. ☐ Copy of document is not readable (*please resubmit request*).

"PRUCOL"

For Purposes Of Determining If Alien Is Permanently Residing Under Color Of Law Only!

16. ☐ INS actively pursues the expulsion of an alien in this class/category.
17. ☐ INS **is not** actively pursuing the expulsion of an alien in this class/category, at this time.
18. ☐ Other

Instructions

- **Submit copies of both** *front and back* of alien's original documentation.
- **Make certain a complete return address** has been entered in the "From" portion of the form.
- The Alien Registration Number ("A" Number) is the letter "A" followed by a series of (7) or (8) digits. Also in this block may be recorded the number found on Form I-94. (Check the front and back of the I-94 document and if the "A" Number appears, record that number when requesting information instead of the longer admission number as the "A" Number refers to the most integral record available.)
- If Form G-845 is submitted without copies of applicant's original documentation, it will be returned to the submitting agency without any action taken.
- Address this verification request to the local office of the Immigration and Naturalization Service.

APPENDIX 1-G

SUPPLEMENTAL AFFIDAVIT TO SBA FORM 912

Proposed SBA Borrower: _____

**SUPPLEMENTAL AFFIDAVIT TO SBA FORM 912, STATEMENT OF
PERSONAL HISTORY**

I, _____, the applicant or principal of applicant of application mentioned above, attest that no offenses, other than those cited on the SBA Form 912, Statement of Personal History, submitted with this loan application, appear on my record.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on this _____ day of _____, 20____.

Affiant

DETAILS OF OFFENSE(S)

CHARGE(S):	
DATE OF INCIDENT:	
LOCATION OF INCIDENT:	
FINE(S) AND/OR SENTENCE:	
MISDEMEANOR OR FELONY:	
DATE PAROLE/PROBATION:	
UNPAID FINES OR PENALTIES:	
NAME CHARGED UNDER:	
EXPLANATION OF INCIDENT:	

SIGNATURE

DATE